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AUDIT AND MANAGEMENT CONSULTING DIVISION
OFFICE OF INTERNAL OVERSIGHT SERVICES

Reference: AUD-7-7:7 (1313 /02)

12 September 2002

To: Mr. Rolf G. Knutsson, Executive Secretary
United Nations Compensation Commission

From: Esther Stern, Director
Internal Audit Division, OIOS

A handwritten signature in dark ink, appearing to be 'Esther Stern', written over the printed name and title.

Subject: **Assignment no. AF2002/108/1: Risk assessment of UNCC**

1. I am pleased to present herewith our report on the above review, which was conducted in Geneva during July 2002.
2. As you can see from the conclusion of the report, OIOS is of the view that there are areas of significant risks that can have a high impact on the work of UNCC should they occur. OIOS also concluded in the report that while the processing controls are generally adequate, the very nature of UNCC's work, the high reliance on consultants, and the use of the panels as a controls mechanism can expose UNCC to various types of irregular activities. Furthermore, the claim payment process still has not adequately addressed the issue of payment by the paying agent to the claimants.
3. In view of the risk assessment, OIOS has reassessed its resource requirements in order to provide adequate assurance on the reliability of the work of UNCC. The increased level of resources would also enable us to review some claims, before they are presented to the Governing Council for approval – something that we believe will avoid the appearance of reviewing decisions already made by the Governing Council. OIOS has therefore concluded that an additional two audit posts are required for a total of three auditors. In this regard, I wish to express my gratitude for your support to obtain another additional post and I would again very much appreciate your favourable consideration of the revised requirements.
4. Should you wish to discuss this matter further, please feel free to contact me at any time.

Cc: Mr. D. Nair
Mr. D. Knutsen



United Nations
OFFICE OF INTERNAL OVERSIGHT SERVICES
Internal Audit Division

REPORT

Subject: Risk Assessment of UNCC
Audit No.: AF2002/108/1
Report date: 12 September 2002
Audit team: Dagfinn Knutsen, Auditor-in-Charge
Bharat Manocha, Auditor



I. INTRODUCTION

1. UNCC was established as a subsidiary organ of the United Nations Security Council as a result of a decision made by Security Council resolution 687(1991). Its mandate is to process claims and pay compensation for losses and damages suffered as a direct result of Iraq's invasion of Kuwait. Compensation is payable to successful claimants from a Compensation Fund that receives 25 per cent of its funds from Iraqi oil revenues. UNCC is composed of three bodies: the Governing Council, the Panels of Commissioners and the Secretariat.

2. UNCC has received approximately 2.6 million claims from individuals, corporations, governments and international organizations seeking compensation for alleged losses worth more than \$300 billion. The UNCC has verified more than 2.5 million claims with an asserted value of \$142 billion. Figure 1 shows the status of claims as at 23 July 2002. As well as processing cases in-house, UNCC has engaged consultants to assist in processing many of the remaining claims for losses suffered by corporations, governments and international organizations, with an asserted value of \$180 billion. To date, the work of UNCC and the panels' review of the claims is on target, however it is likely that certain complex environmental claims will require additional processing time. Barring unforeseen developments, UNCC expects to complete its work programme by the end of 2003, except for F4 environmental claims and the late claims filed by the Palestinians.

Figure 1: Status of Claims Processing

Category	No. of claims to be resolved	Compensation sought by claims to be resolved (US\$ approx.)	No. of claims resolved	Compensation sought by claims resolved (US\$)	No. of resolved claims awarded compensation	Compensation awarded (US\$)	US\$ paid
"A"	0	0	919,701	3,451,522,500	860,181	3,197,211,000	3,193,306,985
"B"	0	0	5,734	20,100,000	3,941	13,450,000	13,450,000
"C"	0	0	1,659,835	8,754,604,152	633,125	4,986,689,352	4,980,031,297
"D"	4,618	8,790,000,000	6,186	2,728,630,513	5,590	1,289,497,877	1,285,175,194
"E1"	51	584,000,000	53	44,019,866,179	30	21,388,832,542	470,025,616
"E2"	1,081	2,170,000,000	1,358	11,566,937,391	541	770,279,934	697,379,058
"E3"	76	1,090,000,000	322	6,766,893,049	132	344,295,065	286,458,375
"E4"	758	1,850,000,000	1,991	9,317,740,873	1,720	2,721,830,479	2,465,229,137
"E/F"	50	5,100,000,000	73	1,072,814,148	50	306,431,342	107,096,841
"F1"	0	0	100	18,607,934,491	70	291,171,423	216,001,537
"F2"	0	0	63	17,573,716,993	46	264,422,123	185,356,070
"F3"	3	96,500,000,000	60	17,562,849,707	59	6,754,381,226	1,406,639,149
"F4"	63	64,900,000,000	105	985,750,332	69	243,234,967	243,234,967
Total	6,700	180,984,000,000	2,595,581	142,429,360,328	1,505,554	42,571,727,329	15,549,384,227

Source: UNCC Website - 23 July 2002



3. In view of the inherent risks in processing asserted claims valued at approximately \$320 billion it is essential that adequate procedures be established to prevent or mitigate risks associated with the processing of the claims. Another factor is the work plan that calls for the completion of the majority of claims by end of 2003 and environmental claims by end of 2004. Accordingly OIOS conducted a comprehensive Risk Assessment of UNCC in Geneva during July 2002 to assess the risks/constraints faced by UNCC in achieving its objectives.

4. The UN Board of Auditors recommended in their 2002 draft management letter that OIOS conduct a joint risk assessment with UNCC management. However, in accordance with general and specific standards for the professional practice of internal auditing in the United Nations organizations which require an assessment of risks of the audited entity, a risk assessment was undertaken of UNCC's operations. The assessment was conducted in cooperation with UNCC and included interview sessions with senior UNCC managers of all sections in order to obtain their views. These have been incorporated in the risk assessment results as appropriate.

II. OBJECTIVES

5. The objectives of the risk assessment were to:

- (i) Develop a profile of significant risk areas that may be obstacles in fulfilling UNCC's objectives;
- (ii) Develop a risk based audit strategy to ensure adequate coverage of high-risk areas; and
- (iii) Determine resources required to provide adequate audit coverage.

III. SCOPE & METHODOLOGY

6. The audit reviewed the activities of the Claims processing Section including LSB and VWSB, Claims Payment Section, Information Systems Section and the Executive office operations of UNCC. The following methodology was used:

- Discussions were held with the senior UNCC staff to determine unit objectives, constraints in achieving these objectives, critical success factors and management's risk mitigation and control monitoring activities.
- Findings from previous OIOS/IAD audits of UNCC were taken into account.
- Relevant issues raised in audit reports of Board Of Auditors were used.
- Reports of the panel of commissioners, UNCC Executive Secretary, decisions of the Governing Council, provisional rules for claims procedures, the organisation chart, and other relevant documents were examined.
- A risk assessment model was used which took into account three types of risk factors: (i) Environmental risks; (ii) Process risks; and (iii) Information for decision-making risks. The significance and likelihood of risks were assessed and classified as High, Medium or Low. An assessment was made of internal controls to prevent or mitigate risks.

IV. FINDINGS

7. UNCC Management explained that they had issued detailed procedures and guidelines



and implemented controls to cover the risks in claims processing. In addition, UNCC believed the following measures contributed to mitigating risks:

- The Panel of Commissioners were a major safeguard in claims processing;
- The claim consultants provide a variety of expertise and experience;
- Reliable database enabled them to cross check for duplicate claims; and
- Participation of respective governments helped to prevent fraudulent claims.

UNCC management stated they were generally satisfied with the procedures in place and considered that the present level of checks and balances in the system were adequate to prevent or mitigate risks involved in processing the claim and the valuation of loss. Our assessment has taken these factors into account.

8. Inherent risks in the process include:

- The unique nature of the claims;
- The range of claims received vary from personal claims requiring valuation of antiques to jewellery, to complex corporate claims for contract related losses, damage to environment and depletion of natural resources, governments claims for humanitarian relief provided, etc.;
- The general emergency conditions in which thousands were forced to flee (from Kuwait & Iraq), without retaining the evidence that could be used to substantiate their losses; and
- The distinct difference in the quality, patterns, relevance and materiality of evidence submitted by claimants from different countries and within countries by education and income.

9. The results of the assessment, taking into account the significance and likelihood of the risks and the evaluation of controls to prevent or mitigate them, are summarized in Figure 2.

Figure 2: Risk Assessment Summary

Risk Item	Risk Assessment	Control Assessment
I. Environmental Risk	<ul style="list-style-type: none"> • Although the impact was only low to medium the likelihood ranged from low to high. 	<ul style="list-style-type: none"> • Controls to monitor these risks appeared to be adequate. • Unforeseen political developments could affect claim processing and payment. • Controls are generally adequate. • However, there is a need to monitor the claims processing closely because the claims being processed are large and complex and even small or minor errors can have significant financial impact. • Some UNCC managers believed staff retention was a major risk, especially specialized staff in the environmental areas.
II. Process Risk – Operations	<ul style="list-style-type: none"> • Although the impact was medium, the likelihood was medium to high. 	



II. Process Risk - Empowerment	Leadership, authority limit and Outsourcing could have a high impact, moreover risks were generally ranked medium to high likelihood.	<ul style="list-style-type: none"> • Controls in this area needed to be strengthened. • Reluctance to fully cooperate with internal auditors.
II. Process Risk - Information Processing/Technology Claims Database	<ul style="list-style-type: none"> • Integrity and Access Risks were judged to have a high significance though the likelihood was low. 	<ul style="list-style-type: none"> • The controls appear to be adequate and recent BOA audit revealed no major IT weaknesses. • However, user guides and manuals had not been prepared to adequately document software developed in-house.
II. Process Risk - Integrity	<ul style="list-style-type: none"> • Employee fraud and impartiality was both significant and likely. Impact could be high and also result in loss of reputation with GC and claimants and other stakeholders. 	<ul style="list-style-type: none"> • Controls to prevent employee fraud were marginal, and some weaknesses had been noted that needed to be addressed. • Requires close monitoring to prevent possible collusion. • Possibilities exist for illegal activities resulting in loss of reputation, etc. Monitoring and control of employee activities are not considered adequate.
II. Process Risk - Financial Payment of claims	<ul style="list-style-type: none"> • The impact and the likelihood of risk concerning payment of claims are high. 	<ul style="list-style-type: none"> • Payment processing controls were inadequate. • Additional review needed to fully assess them. • Controls to ensure final payment to claimant had not been established. • Risks concerning contractual commitments should be regularly monitored. • Adequacy of budget was a concern in discussions as the GC was in some instances reluctant to approve budget requests.
III. Information for decision-making risk - Operational	<ul style="list-style-type: none"> • Risks were considered medium impact and likelihood. 	
III. Information for decision-making risk - Financial	<ul style="list-style-type: none"> • Impact was considered to be low while likelihood was medium. 	<ul style="list-style-type: none"> • Adequacy of budget was a concern in discussions as the GC was in some instances reluctant to approve budget requests.
III. Information for decision-making risk - Strategic	<ul style="list-style-type: none"> • The impact was considered to be medium while the likelihood of occurrence was low to medium. 	<ul style="list-style-type: none"> • Monitoring of factors that may impact on downsizing of operations should be closely monitored on a regular basis. • Performance measures had not been established hence monitoring of performance considered to be weak. • Monitoring of work plan progress was a positive aspect.

Overall assessment

10. As a result of the risk assessment, OIOS/IAD identified significant risks in the following



functional areas:

- Claim review process;
- Claim payment process;
- Staffing of operations resulting from downsizing activities; and
- Changes made by GC, e.g. approval of late claims for processing.

OIOS/IAD also observed that while UNCC has detailed procedures and controls – however there is no explicit risk policy, documented or endorsed by UNCC, available to the staff and subject to regular review. Furthermore, internal quality control procedures are not fully independent from claims processing management.

Audit strategy

11. Given the nature of the claims processing and the political sensitivity it is difficult to reverse decisions made by the GC. Furthermore, since the respective "Claim Teams" are wound up soon after completion of their work plans, staff may not be available to provide clarifications if audits of claims are not done promptly. IAD/OIOS therefore agrees with UNCC management that it would be appropriate for IAD, to the extent possible, to review the claim and report findings to UNCC before claims are sent to the GC. It has also come to our attention that late reviews may incur additional expenses as a result of explanations required from consultants.

12. As per the UNCC work plan the GC is expected to consider the following reports (Figure 3) in its sessions:

Figure 3: Planned GC Sessions

Target Governing Council Session	No. Of Reports proposed to be considered during the session*
45 th Session September 2002	7
46 th Session December 2002	6
47 th Session March 2003	8
48 th Session June 2003	7
49 th Session September 2003	5
50 th Session December 2003	6
TOTAL	39

* Excludes the F4 environment & late claims filed by the Palestinians

Each "D" Panel Report covers approx. 400 - 500 claims. While each of the 'E' and 'F' Panels report on a smaller number of claims – however the amounts involved are substantial. For example, the 'F3' Panel is expected to make its recommendations on the KIA claim in December 2002. This is the largest asserted claim received by UNCC (\$86 billion) and we estimate it would require two full time auditors for 4 months to audit the claim if it is to be completed before the Governing Council decides on the recommendations of the panel.

V. CONCLUSION

13. Significant risks have been identified in the processing operations (use of outside expertise, high reliance on panels as a control mechanism, and inadequate scrutiny of claim



conclusions arrived at by consultants), integrity in claim processing area, empowerment and claim payment . These risks can result in inadequate or overcompensation of claims, irregular or fraudulent activities, and result in severe repercussions to the reputation of UNCC that can affect its ability to complete its work. UNCC still has significant work ahead to finalize claim processing by the end of 2004. It has been recognized by UNCC management that audit resources are inadequate to fully address the risks faced by UNCC. In this regard, UNCC has agreed to provide an additional auditor. Based on the risk assessment, experience in conducting audits of UNCC, and the complexity of the claim review process, OIOS is of the view that in order to provide adequate assurance to management and to be able to review some major claims before being considered by the GC that an additional two auditors will be required, for a total of three auditors until the end of the major part of the claim processing slated for completion by the end of 2004.